Report

of the

Examination of

Tower Insurance Company, Inc.

Pewaukee, Wisconsin

As of December 31, 2000

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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***Connie L. O'Connell,*** *Commissioner*

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August 17, 2001

Honorable Sally McCarty
Secretary, Midwestern Zone III, NAIC
Commissioner of Insurance
State of Indiana
311 West Washington Street, Suite 300
Indianapolis, IN 46204-2787

Honorable Connie L. O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, WI 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

TOWER INSURANCE COMPANY, INC.
Pewaukee, Wisconsin

and this report is respectfully submitted.

## I. INTRODUCTION

The previous examination of the company was conducted in 1995 as of December 31, 1993. The current examination covered the intervening period ending December 31, 2000, and included a review of such 2001 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control

Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company’s operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results” contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

## II. HISTORY AND PLAN OF OPERATION

Tower Insurance Company, Inc.; (the company or Tower) was organized in 1960, as Tower Fire and Casualty, Inc. The company was organized as a subsidiary of Catholic Knights Insurance Society, a Wisconsin-domiciled fraternal benefit society, to offer property and casualty products to its membership. The present name of the company was adopted on January 3, 1961.

In May 1972, a controlling interest in Tower Insurance Company, Inc., was purchased by Fiduciaries, Inc., a publicly held holding company domiciled in Wisconsin.

During the period between December 15, 1978 and March 5, 1979, through a complex series of mergers and corporate reorganizations, Tower Insurance Company, Inc., and its parent Fiduciaries, Inc. were merged into a newly created Wisconsin insurer, Custodian Insurance Company, Inc., with the latter company surviving.

Custodian Insurance Company, Inc., an indirect wholly owned subsidiary of Guardian Royal Exchange, plc, was incorporated on February 23, 1979. It commenced business on March 5, 1979, effective with the final merger transaction with Tower. This final merger transaction dissolved the existence of the original Tower as an independent entity and cancelled all of its issued and outstanding common stock. The surviving Custodian Insurance Company, Inc. changed its name to Tower Insurance Company, Inc., concurrent to the final merger transaction. In this way, Tower became an indirect wholly owned subsidiary of Guardian Royal Exchange, plc, (GRE).

On April 18, 1996, Atlas Assurance Company of America, a New York domiciled company in the GRE holding company system, received permission to acquire control of Tower. GRE sold its United States operations, including Tower, to Liberty Mutual Insurance Company (LMIC) on April 29, 1999. The current holding company structure is located in the Affiliated Company section of this report.

In 2000, the company wrote direct premium in the following states:

| | | |
|---|---|---|
| Illinois | $113,413 | 12.2% |
| Iowa | 27,106 | 2.9 |
| Minnesota | 602,075 | 64.9 |
| Nebraska | 13,671 | 1.5 |
| Pennsylvania | 306 | 0.0 |
| Wisconsin | 171,231 | 18.5 |
| | $927,802 | 100% |

The company is also licensed in the following states but had no direct premium: Colorado, Indiana, Kansas, Michigan, Missouri, Montana, North Dakota, and South Dakota.

The company has stopped writing new business and is moving renewals to other affiliates as the law permits. The business is ceded under a 100% quota share reinsurance contract with Atlas Assurance Company of America (Tower's parent). The major products included Private Passenger Auto Liability and Auto Physical Damage and were marketed through one independent agent.

The following table is a summary of the direct and net insurance premiums written by the company in 2000. The growth of the company is discussed in the Financial Data section of this report.

| Line of Business | Direct Premium | Reinsurance Assumed | Reinsurance Ceded | Net Premium |
|---|---|---|---|---|
| Fire | ($9,204) | $ | ($9,204) | $0 |
| Allied lines | ( 1,784) | | ( 1,784) | 0 |
| Homeowner's multiple peril | (82,207) | | (82,207) | 0 |
| Commercial multiple peril | 206,454 | | 206,454 | 0 |
| Inland marine | (12,918) | | (12,918) | 0 |
| Earthquake | (35) | | (35) | 0 |
| Worker's compensation | (159,243) | 14,999 | (144,244) | 0 |
| Other liability - occurrence | (5,536) | | (5,536) | 0 |
| Private passenger auto liability | 586,946 | | 586,946 | 0 |
| Commercial auto liability | (43,998) | | (43,998) | 0 |
| Auto physical damage | 449,327 | | 449,327 | 0 |
| Total All Lines | $927,802 | $14,999 | $942,801 | $ 0 |

## III. MANAGEMENT AND CONTROL

### Board of Directors

The board of directors consists of eleven members. All directors are elected annually to serve a one-year term. Officers are elected at the board's annual meeting. Members of the company's board of directors may also be members of other boards of directors in the holding company group. The board members currently receive no compensation for serving on the board.

Currently the board of directors consists of the following persons:

| Name and Residence | Principal Occupation | Term Expires |
|---|---|---|
| Richard T. Bell<br>Loveland, OH | President, Indiana Ins. Co.,<br>Liberty Regional Agency Markets | 2002 |
| J. Paul Condrin III<br>Walpole, MA | Sr. VP and CFO LMIC | 2002 |
| Honore J. Fallon<br>Belmont, MA | VP and Asst. Gen. Counsel LMIC | 2002 |
| Mark E. Fiebrink<br>Amherst, NH | Manager, Finance, Actuarial and Planning LMIC, Exec. VP and CFO, Liberty Regional Agency Markets | 2002 |
| Roger L. Jean<br>Amherst, NH | Exec. VP, LMIC<br>President Liberty Regional Agency Markets | 2002 |
| Forrest H. Johnson<br>Keene, NH | Manager, RAM Claims, LMIC<br>Sr. VP, Liberty Regional Agency Markets | 2002 |
| Dennis J. Langwell<br>Franklin, MA | Vice-President and Comptroller,<br>Corporate Finance, LMIC | 2002 |
| Amy J. Leddy<br>Weston, MA | Manager Operations, LMIC<br>Sr. VP, Liberty Regional Agency Markets | 2002 |
| Christopher C. Mansfield<br>Dedham, MA | Sr. VP and Corporate Counsel, LMIC | 2002 |
| William G. Mersch<br>Groton, Ma | Manager, HR and Admin Services LMIC<br>Sr. VP, Liberty Regional Agency Markets | 2002 |
| Charles B. Ruzicka<br>Mason, OH | Manager, Info Technologies, LMIC<br>Sr. VP, Liberty Regional Agency Markets | 2002 |

**Officers of the Company**

The officers serving at the time of this examination are as follows:

| Name | Office | 2000 Compensation |
|---|---|---|
| Richard Thomas Bell | President & CEO Indiana Ins. Co. | 291,168 |
| Joseph Yeager | VP, Company Marketing | 191,859 |
| Joseph Tracey | VP, Finance | 177,263 |
| Mark Fiebrink | SVP, Finance & Actuarial | 278,994 |
| Forrest Johnson | SVP, Claims | 176,544 |
| Michael Christiansen | President & CEO Peerless Ins. Co. | 225,011 |
| Steve Fulwood | President & CEO Montgomery Ins. Co. | 199,668 |
| Charles Ruzicka | SVP, Technology | 191,539 |
| Danny Laffey | VP, Tech Solutions | 149,921 |
| Kevin Kowar | RVP, WIRO-Regional Director WI Operations | 118,499 |

The above figures reflect the total compensation paid to the company's officers for their service for Tower and other Liberty Mutual companies. Any salary allocation to Tower is transferred to Atlas Assurance Company of America (an affiliate) under the 100% quota share reinsurance agreement.

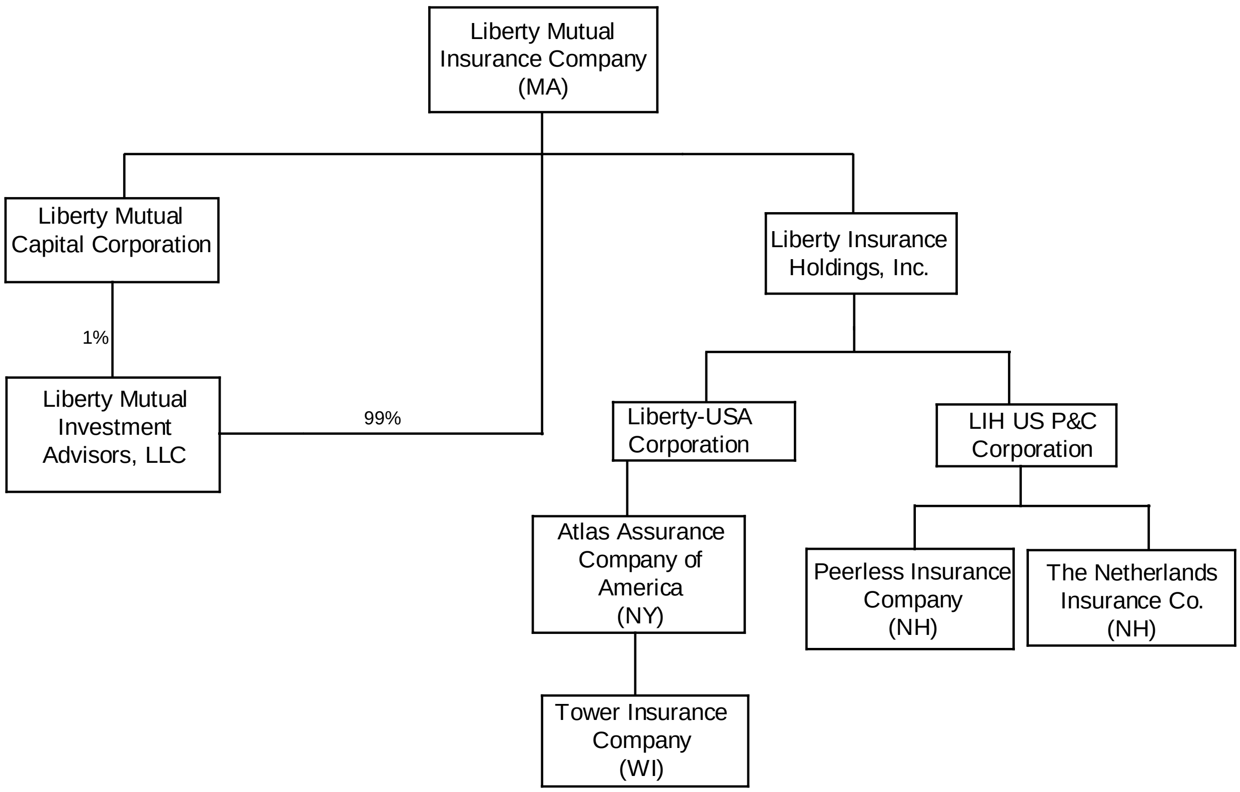
**Committees of the Board**

The company's bylaws allow for the formation of certain committees by the board of directors. There were no committees at the time of the examination.

## IV. AFFILIATED COMPANIES

Tower is a member of a holding company system. The organizational chart on this page depicts the relationships among the affiliates in the group that were deemed important to Tower's operations. A brief description of the significant affiliates of Tower follows.

**Organizational Chart**
**As of December 31, 2000**




**Liberty Mutual Insurance Company (LMIC)**

LMIC is the ultimate parent of Tower and the owner of a large diversified holding company system whose products and services include property and casualty, health, and life insurance, and investment and management services. LMIC has an agreement to manage and invest the company's investment portfolio and a tax sharing agreement with the company. As of December 31, 2000, the company's audited financial statement reported assets of $19,161,359,596, liabilities of $13,643,650,567, and unassigned funds and special reserves of $5,517,709,029. Operations for 2000 produced net income of $124,368,771.

**Liberty Insurance Holdings, Inc. (LIHI)**

LIHI is a holding company, domiciled in Delaware, which is wholly owned by LMIC and is engaged primarily in insurance activities through its subsidiaries. As of December 31, 2000, the company's unaudited financial statement reported assets of $1,449,406,908, liabilities of $8,318,782, and stockholders equity $1,441,088,126. Operations for 2000 produced net income of $12,264,182.

**Liberty-USA Corp. (LUSAC)**

LUSAC is a holding company, domiciled in Delaware, which is wholly owned by LIHI and is engaged primarily in insurance activities through its subsidiaries. As of December 31, 2000, the company's unaudited financial statement reported assets of $511,782,597, liabilities of $5,629,973, and stockholders equity of $506,152,624. Operations for 2000 produced net income of $15,740,051.

**Atlas Assurance Company of America (Atlas)**

Atlas provides property and casualty insurance and is wholly owned by LUSAC. As of December 31, 2000, the company's audited financial statement reported assets of $920,883,615, liabilities of $548,314,809, and unassigned funds and special reserves of $372,568,806. Operations for 2000 produced net income of $22,588,314.

Tower has a 100% quota share reinsurance contract with Atlas dated September 1999. All business written or assumed by Tower is reinsured through Atlas according to this contract. More detail on the contract terms is located in the Reinsurance section of this report.

**Peerless Insurance Company (PIC)**

PIC is a New York-domiciled property and casualty company with no employees. As of December 31, 2000, the company's audited financial statement reported assets of $731,543,765, liabilities of $515,951,579, and unassigned funds and special reserves of $215,592,186. Operations for 2000 produced net income of $11,303,165.

**Liberty Mutual Investment Advisors, LLC (LMIA)**

LMIA is a Massachusetts limited liability corporation that is an indirect subsidiary of LMIC (99% owned LMIC and 1% owned by Liberty Mutual Capital Corporation). LMIA provides cash management services to companies within the LMIC holding company structure. As of December 31, 2000, the company's audited financial statement reported assets of $544,533,045, liabilities of $5,458,239, and unassigned funds and special reserves of $539,074,806. Operations for 2000 produced net income/loss of $25,722,584.

LMIA manages the short-term investments of Tower per the agreement.

**Service Agreement with Affiliate**

Tower has no employees of its own. The company has a services agreement with PIC. PIC has no employees but has an agreement with another affiliate, The Netherlands Insurance Company (TNIC). PIC utilizes the employees of TNIC to provide the services to Tower. The services include: services of their executive officers and employees, accounting, tax reporting, treasury management, human resource, administrative, communication, marketing, planning and budgeting, legal, insurance program to protect Tower's assets, actuarial, internal audit, information technology, corporate purchasing, central processing, underwriting and may provide other services as agreed upon by Tower and PIC.

## V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The contracts contained proper insolvency provisions.

In addition to the following quota share reinsurance with its affiliate, the company had two facultative certificates still in force.

**Affiliated Ceding Contracts**

| | | |
|---|---|---|
| 1. | Type: | 100% Quota Share |
| | Reinsurer: | Atlas Assurance Company of America |
| | Scope: | All business written by the company |
| | Retention: | None |
| | Coverage: | All business written |
| | Premium: | 100% of net premiums written |
| | Commissions: | Amount equal to company's underwriting expenses, plus policyholders' dividends, and agents balances charged-off less finance and service charges not included in premium. |
| | Effective date: | October 1, 1999 |
| | Termination: | 90 days prior written notice |

## VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2000, annual statement to the Commissioner of Insurance. Also included in this section are schedules, which reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Members' Surplus per Examination."

**Tower Insurance Company, Inc.**
**Assets**
**As of December 31, 2000**

| | Ledger Assets | Nonledger Assets | Nonadmitted Assets | Admitted Assets |
|---|---|---|---|---|
| Bonds | $22,837,940 | $ | $ | $22,837,940 |
| Cash | (3,180,864) | | | (3,180,864) |
| Short-term investments | 6,613,985 | | | 6,613,985 |
| Reinsurance recoverables on loss and adjustment payments | 851,480 | | | 851,480 |
| Electronic data processing equipment | 31,004 | | | 31,004 |
| Interest, dividends, and real estate income due and accrued | | 441,368 | | 441,368 |
| Equities and deposits in pools and associations | (531,769) | | | (531,769) |
| Equipment, furniture, and supplies | 193,469 | | 193,469 | 0 |
| nonadmitted assets: Leasehold Improvements | 165,896 | | 165,896 | 0 |
| Total Assets | $26,981,141 | $441,368 | $359,365 | $27,063,144 |

**Tower Insurance Company, Inc.**
**Liabilities, Surplus, and Other Funds**
**As of December 31, 2000**

| | |
|---|---|
| Federal and foreign income taxes (excluding deferred taxes) | $ 856,083 |
| Provision for reinsurance | 300,467 |
| Payable to parent, subsidiaries, and affiliates | 130,575 |
| Write-ins for liabilities: | |
| Accounts Payable | 239 |
| Reserve for unpresented checks | 3,103 |
| Total Liabilities | 1,290,467 |
| Common capital stock | 2,000,000 |
| Gross paid in and contributed surplus | 7,784,101 |
| Unassigned funds (surplus) | 15,988,576 |
| Surplus as Regards Policyholders | 25,772,677 |
| Total Liabilities, Surplus, and Other Funds | $27,063,144 |

**Tower Insurance Company, Inc.**
**Summary of Operations**
**For the Year 2000**

| | |
|---|---|
| **Investment Income** | |
| Net investment income earned | $1,522,033 |
| Net investment gain or loss | 1,522,033 |
| | |
| Net income before dividends to policyholders and before federal and foreign income taxes | 1,522,033 |
| Net income after dividends to policyholders but before federal and foreign income taxes | 1,522,033 |
| Federal and foreign income taxes incurred | 537,273 |
| | |
| Net Income | $ 984,760 |

**Tower Insurance Company, Inc.**
**Cash Flow**
**As of December 31, 2000**

| | | | |
|---|---|---|---|
| Loss and loss adjustment expenses paid (net of salvage or subrogation) | $ 25,351 | | |
| Cash from underwriting | | ( 25,351) | |
| Investment income (net of investment expense) | | 1,570,146 | |
| Other income (expenses): | | | |
| Net amount withheld or retained for account of others | (1,181) | | |
| Write-ins for miscellaneous items: | | | |
| Equities and deposits in pools and associations | 531,769 | | |
| Total other income | | 530,588 | |
| Net cash from operations | | | $2,075,383 |
| Proceeds from investments sold, matured, or repaid: | | | |
| Bonds | 1,028,747 | | |
| Miscellaneous proceeds | 19,871 | | |
| Total investment proceeds | | 1,048,618 | |
| Cost of investments acquired (long-term only): | | | |
| Bonds | 3,991,364 | | |
| Total investments acquired | | 3,991,364 | |
| Net cash from investments | | | (2,942,746) |
| Cash provided from financing and miscellaneous sources: | | | |
| Net transfers from affiliates | 3,290,561 | | |
| Other cash provided | 980,129 | | |
| Total | | 4,270,690 | |
| Net cash from financing and miscellaneous sources | | | 4,270,690 |
| Net change in cash and short-term investments | | | 3,403,327 |
| **Reconciliation** | | | |
| Cash and short-term investments, December 31, 1999 | | | 29,794 |
| Cash and short-term investments, December 31, 2000 | | | $3,433,121 |

**Tower Insurance Company, Inc.**
**Compulsory and Security Surplus Calculation**
**December 31, 2000**

| | | |
|---|---|---|
| Assets | $27,063,144 | |
| Less liabilities | 1,290,467 | |
| Adjusted surplus | | $25,772,677 |
| Compulsory surplus excess (or deficit) | | $25,772,677 |
| Adjusted surplus | | $25,772,677 |
| Security surplus excess (or deficit) | | $25,772,677 |

**Tower Insurance Company, Inc.**
**Reconciliation and Analysis of Surplus**
**For the Five-Year Period Ending December 31, 2000**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements

| | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Surplus, beginning of year | $23,631,943 | $25,575,395 | $23,958,391 | $24,356,542 | $24,653,158 |
| Net income | 1,704,014 | (1,240,336) | (113,357) | (56,819) | 984,760 |
| Net unrealized capital gains or (losses) | 420,043 | 342,409 | (82,552) | (5,779,226) | 0 |
| Change in nonadmitted assets | (178,320) | 303,100 | (466,244) | 211,122 | 66,899 |
| Change in provision for reinsurance | 83,000 | 0 | (294,000) | (45,327) | 67,860 |
| Change in foreign exchange adjustment | 93,715 | (71,677) | 5,697 | (32,134) | |
| Change in excess of statutory reserves over statement reserves | (179,000) | (950,500) | 1,785,500 | 5,999,000 | |
| Write-ins for gains and (losses) in surplus: | | | | | |
| Prior Period Adj W/C Pool | | | (436,893) | | |
| Surplus, end of year | $25,575,395 | $23,958,391 | $24,356,542 | $24,653,158 | $25,772,677 |

**Tower Insurance Company, Inc.**
**Insurance Regulatory Information System**
**For the Five-Year Period Ending December 31, 2000**

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios may be found after the IRIS ratios.

| | Ratio | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| #1 | Gross Premium to Surplus | 234.0% | 263.0% | 266.0% | 134.0% | 4.0% |
| #1A | Net Premium to Surplus | 226.0 | 255.0 | 259.0 | 36.0 | 0.0 |
| #2 | Change in Net Writings | 3.0 | 6.0 | 5.0 | -86.0* | -99.0* |
| #3 | Surplus Aid to Surplus | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| #4 | Two-Year Overall Operating Ratio | 94.0 | 104.0* | 106.0* | 123.0* | 222.0* |
| #5 | Investment Yield | 5.7 | 5.5 | 5.4 | 9.1 | 6.7 |
| #6 | Change in Surplus | 6.0 | -2.0 | 5.0 | -28.0* | 5.0 |
| #7 | Liabilities to Liquid Assets | 82.0 | 82.0 | 82.0 | 3.0 | 4.0 |
| #8 | Agents' Balances to Surplus | 22.0 | 19.0 | 15.0 | 0.0 | 0.0 |
| #9 | One-Year Reserve Devel. to Surplus | 6.0 | 15.0 | -24.0 | 0.0 | 0.0 |
| #10 | Two-Year Reserve Devel. to Surplus | 27.0* | 20.0* | 12.0 | 0.0 | 0.0 |
| #11 | Estimated Current Reserve Def. To Surplus | 0.0 | -4.0 | -24.0 | 121.0* | 0.0 |

Ratio No. 2 measures the company's change in net writings and 1999 and 2000. The decline of 99% is due to a new 100% quota share reinsurance contract with Atlas Assurance Company of America. Ratio No. 4 measures the company's profitability over the previous two-year period. The exceptional results in 1999 and 2000 were due to the company no longer retaining any net business. The exceptional ratio for 1997 is due to storms and reserve strengthening. Ratio No. 6 shows the change in surplus from year to year. Year 1999 is exceptional due to the new 100% quota share reinsurance contract mentioned above. Ratio No. 10 compares reserve development to surplus and was exceptional in 1996 and 1997 due to under reserving in the prior years. The company strengthened the reserves in 1997 due to growth in personal lines. Ratio No. 11 compares reserve deficiency to surplus and includes a factor for premium volume. The exceptional result in 1999 was due to 100% quota share reinsurance contract with affiliate Atlas Assurance Company of America.

**Growth of Tower Insurance Company, Inc.**

| Year | Admitted Assets | Liabilities | Surplus As Regards Policyholders | Net Income |
|---|---|---|---|---|
| 1996 | $100,618,717 | $75,043,322 | $25,575,395 | $1,704,014 |
| 1997 | 106,996,380 | 83,037,989 | 23,958,391 | (1,240,336) |
| 1998 | 112,745,968 | 88,389,426 | 24,356,542 | (113,357) |
| 1999 | 25,344,579 | 691,421 | 24,653,158 | (56,819) |
| 2000 | 27,063,144 | 1,290,467 | 25,772,677 | 984,760 |

| Year | Gross Premium Written | Net Premium Written | Premium Earned | Loss And LAE Ratio | Expense Ratio | Combined Ratio |
|---|---|---|---|---|---|---|
| 1996 | $59,736,795 | $57,828,463 | $55,714,606 | 73.0% | 29.6% | 102.6% |
| 1997 | 62,891,999 | 61,110,310 | 59,608,109 | 81.3 | 31.7 | 113.0 |
| 1998 | 66,015,794 | 64,261,498 | 62,515,369 | 75.5 | 33.2 | 108.7 |
| 1999 | 33,081,997 | 8,965,930 | 44,039,090 | 93.9 | 140.5 | 234.4 |
| 2000 | 942,801 | 0 | 0 | 0.0 | 0.0 | 0.0 |

Effective October 1, 1999, the company began ceding 100% of its business to an upstream affiliate. The notable changes in the company results for 1999 and 2000 relate to these changes in reinsurance. The company has discontinued writing business with renewals being written by affiliates as the law permits. Subsequent to the examination, on October 30, 2001, Liberty Mutual Insurance Company, the ultimate parent of the company, entered into a partnership agreement with OneBeacon Corporation under which companies of LMIC's Regional Agency Markets strategic business unit would assume much of the property and casualty business written through OneBeacon underwriting companies in 42 states. As part of this agreement, business written through Hawkeye Secuirty Insurance Company will be assumed and rewritten through Tower in the states of Minnesota, Wisconsin, Missouri, Iowa, North Dakota, South Dakota, Nebraska and Kansas, subject to Towers underwriting standards and individual state law and regualtion. LMIC also acquired the rights to the Hawkeye name. The company is considering changing Tower's name to Hawkeye sometime in the year 2002.

**Reconciliation of Surplus per Examination**

There were no adjustments to members' surplus as determined by this examination.

Examination Reclassifications

| | Debit | Credit |
|---|---|---|
| Cash-Wachovia CBS D.B. PIC | $691,760.78 | $ |
| Affiliated Balance Payable-Peerless | | 691,760.78 |
| Total reclassifications | $691,760.78 | $691,760.78 |

## VII. SUMMARY OF EXAMINATION RESULTS

**Compliance with Prior Examination Report Recommendations**

There were twenty-one specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Biographical Data—It is again recommended that the company report biographical data relating to company officers and directors in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

   Action—Compliance

2. Agents' Commissions—It is recommended that the company report the actual commission rate schedules in use with future annual statement filings pursuant to s. 628.81, Wis. Stat.

   Action—Compliance

3. Holding Company—It is recommended that Guardian Royal Exchange Assurance, plc, direct its wholly owned subsidiary Guardian Royal Exchange International (Holdings) B.V. to provide an explanation of the terms and conditions of the 1991 change in control. It is further recommended that future changes in control of Tower, whether direct or indirect, be reported in accordance with s. Ins 40.02, Wis. Adm. Code.

   Action—Compliance

4. Affiliated Management Fees—It is recommended that the company revise its affiliated management agreements to provide for reimbursement based on actual costs. It is further recommended that the company retain supporting documentation of how expenses and allocations are calculated for a period of not less than three years in accordance with s. Ins 6.80 (4) (b), Wis. Adm. Code.

   Action—Compliance

5. Stockholder Dividends—It is recommended that the company report extraordinary dividends for review by the Commissioner in accordance with s. 617.225, Wis. Stat. It is further recommended that the company seek the Commissioner's retroactive consent for extraordinary dividends paid from 1989 to 1992, or that it recover from its affiliates the $3,802,573 in extraordinary dividends paid.

   Action—Compliance

6. Affiliated Reinsurance—It is recommended that accounting personnel be given copies of the reinsurance treaties they are responsible to account for.

   Action—Compliance

7. Affiliated Reinsurance—It is recommended that the company obtain the advance approval of Wisconsin's Office of the Commissioner of Insurance for any reinsurance arrangement in which the affiliated participation exceeds 75% pursuant to ss. 601.42 (1g) (a) and 611.61 (1) (c), Wis. Stat.

   Action—Compliance

8. Facultative Reinsurance—It is again recommended that the company establish a system to monitor the placement of the required facultative reinsurance in accordance with the warranties made in its contracts.

   Action—Compliance

9. Fidelity Bond—It is recommended that the company afford itself with fidelity bond coverage in at least the amount suggested by the guidelines of the NAIC.

   Action—Compliance

10. Invested Assets—It is recommended that the company amend its corporate custodian agreement to obligate the custodian to promptly indemnify the company for losses caused by custodial negligence or dishonesty, and to maintain the company's securities in such a manner that at all times they may be identified as belonging solely to the company.

    Action—Compliance

11. Common Stock—It is recommended that the company classify money market mutual funds in accordance with the NAIC Annual Statement Instructions - Property and Casualty in future statutory financial statements.

    Action—Compliance

12. Cash on Hand and on Deposit—It is recommended that the company report checks outstanding net of its cash balances in accordance with the NAIC's Accounting Practices and Procedures Manual for Property/Casualty Insurance Companies, pursuant to s. Ins 50.20 (1) (b), Wis. Adm. Code.

    Action—Compliance

13. Agents' Balances or Uncollected Premiums—It is again recommended that the company reconcile its deferred agents' balances system reports to the general ledger on a regular basis. It is further recommended that the company retain the reconciliations and supporting documentation for a period of not less than three years in accordance with s. Ins 6.80 (4) (b), Wis. Adm. Code. Failure to retain records in accordance with s. Ins 6.80, Wis. Adm. Code, may result in penalties under s. Ins 6.80 (7), Wis. Adm. Code.

    Action—Compliance

14. Losses—It is recommended that the company undertake a formal internal study as to why the 1992 loss reserves have proved so deficient and report the results of this study to the Commissioner, together with the measures proposed to avoid such occurrences in the future.

    Action—Compliance

15. Losses—It is recommended that the company establish an actuarially sound methodology for determining IBNR loss reserves. It is further recommended that the company adjust its loss reserves on a timely basis to bear an appropriate relationship to its obligations pursuant to s. 623.21, Wis. Stat.

    Action—Compliance

16. Losses—It is recommended that the company establish its loss and LAE reserves at not less than the midpoint of the actuarial range of estimates.

Action—Compliance

17. Loss Adjustment Expenses—It is recommended that the company establish an actuarially sound methodology for determining unpaid loss adjustment expense reserves which is consistent with the NAIC Accounting Practices and Procedures Manual for Property/Casualty Insurance Companies, pursuant to s. Ins 50.20 (1) (b), Wis. Adm. Code. It is further recommended that the company adjust its loss adjustment expense reserves on a timely basis to bear an appropriate relationship to its obligations pursuant to s. 623.21, Wis. Stat.

    Action—Compliance

18. Other Expenses—It is recommended that the company report real estate tax accruals in accordance with the NAIC's Accounting Practices and Procedures Manual for Property/Casualty Insurance Companies, pursuant to s. Ins 50.20 (1) (b), Wis. Adm. Code.

    Action—Compliance

19. Taxes, Licenses, and Fees—It is recommended that the company cease to debit the account for accrued guaranty fund assessments when a refund is received, and that it utilize a combination of reasonable expectations and historical experience in establishing the liability for this line item.

    Action—Compliance

20. Other Liabilities—It is recommended that the company comply with ch. 177, Wis. Stat., and the equivalent laws of other states in which it operates. It is further recommended that unclaimed funds be remitted to the company's state of domicile in those instances where the payee's state of domicile is unknown.

    Action—Compliance

21. Commitments and Contingent Liabilities—It is again recommended that the company disclose the nature of this agreement and the associated net balance, if any, in the "Notes to Financial Statements" in accordance with the NAIC Annual Statement Instructions - Property and Casualty.

    Action—Compliance

## Summary of Current Examination Results

### Invested Assets – Cash

During a review of the cash accounts, it was discovered that the company included an amount equal to the checks issued by an affiliate (Peerless Insurance Company) on behalf of Tower. This is incorrect and the amount should have been reported as an affiliated balance payable not a reduction of the company's cash. A reclassification entry was made to transfer the balance on this account ($691,760.78) from cash to affiliated balances payable. It is recommended that the company properly classify all affiliated balances in future annual statements.

### Affiliated Balances Payable

The affiliated balances payable was increased by $691,760.78 due to the classification described in the previous section.

### Holding Company

A review of the affiliate agreement information found that the company did not include Liberty Mutual Investment Advisors, LLC in its organizational chart. It is recommended that the company file an accurate organizational chart according to the NAIC Annual Statement Instructions - Property and Casualty.

## VIII. CONCLUSION

The company discontinued writing new business in 1999 and is moving renewals to other affiliates as the law permits. On its existing business, the company has a 100% quota share reinsurance contract with an upstream affiliate, Atlas Assurance Company of America. The company complied with all prior exam recommendations as noted previously in this report. This examination found two recommendations, which are listed in the next section of this report.

Subsequent to the examination, on October 30, 2001, Liberty Mutual Insurance Company, the ultimate parent of the company, entered into a partnership agreement with OneBeacon Corporation. As part of this agreement, business written through Hawkeye Secuirty Insurance Company will be assumed and rewritten through Tower in the states of Minnesota, Wisconsin, Missouri, Iowa, North Dakota, South Dakota, Nebraska and Kansas, subject to Towers underwriting standards and individual state law and regulation.

## IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 25 - Invested Assets – Cash—It is recommended that the company properly classify all affiliated balances in future annual statements.

2. Page 25 - Holding Company—It is recommended that the company file an accurate organizational chart according to the NAIC Annual Statement Instructions - Property and Casualty.

## X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

| Name | Title |
|---|---|
| DuWayne Kottwitz | Insurance Financial Examiner |

Respectfully submitted,

David A. Grinnell
Examiner-in-Charge